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IN THE

Supreme Court of the United States

May Term, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

v.

FLOOD & CONKLIN MFG. CO.,

Respondent,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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May Term, 1966

PRIMA PAINT CORPORATION,

Petitioner,

against

FLOOD & CONKLIN MFG. CO.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner prays that a writ of certiorari issue to review the judgment and order of the United States Court of Appeals for the Second Circuit (Waterman, Moore and Feinberg, Circuit Judges), entered herein on May 12, 1966 which dismissed petitioner's appeal from an order of the District Court of the United States for the Southern District of New York, granting respondent's motion to stay petitioner's action pending arbitration and denying petitioner's motion to stay respondent from arbitration, pending determination of an action instituted in said Court based upon the diversity of citizenship of the parties, seeking rescission of an agreement for fraud in the inducement thereof.

Citations to Opinions Below

The opinion of the United States District Court for the Southern District of New York (Croake, D. J.) is unreported and is printed *infra*, p. 1A. The opinion in the Court of Appeals is reported in 360 F. 2d 315, and printed *infra*, p. 7A.

Jurisdiction

The jurisdiction of this Court is invoked under 28 U. S. Code §1254(1). The judgment of the Court of Appeals was entered on May 12, 1966.

Questions Presented

1. Whether the Federal Arbitration Act enacted substantive federal law and, in consequence, requires the validity, enforceability and irrevocability of an arbitration clause, assuming *arguendo*, incorporated in a contract evidencing a transaction in interstate commerce, to be determined according to federal law, where such contract was in all other respects governed by state law, where federal jurisdiction existed solely by virtue of diversity of citizenship and where, *concededly*, state law respecting the validity, enforceability and irrevocability of the arbitration clause was contrary to the rule of federal law enunciated and applied by the court below.

2. Whether the federal substantive rule of law (if any there be), applicable to arbitration clauses contained in such contracts, is that a valid, enforceable and irrevocable arbitration clause exists as separable, special agreement between the parties, notwithstanding that it is contained in

a contract evidencing a transaction in interstate commerce, which had been induced by fraud unless it is shown that the fraud specifically relates to the inclusion of the arbitration clause in the fraudulently induced contract.

3. Whether as a matter of such federal substantive law (if any there be), an arbitration clause covering "any controversy or claim arising out of or relating to this agreement, or the breach thereof", requires arbitration of the question of whether the contract containing such arbitration clause has been fraudulently induced.

4. Whether a contract wherein and whereby one of the parties is employed to serve in an advisory and consultative capacity constitutes a contract evidencing a transaction involving interstate commerce.

Statutes Involved

The statutory provisions involved are §§2, 3 and 4 of the Federal Arbitration Act, 61 Stat. 669, 68 Stat. 1233, 9 U. S. C. §§2, 3 and 4, and §7503(c) of the New York Civil Practice Law and Rules. These provisions are reproduced in full, *infra*, p. 1B.

Statement of the Case

Petitioner, Prima Paint Corporation, a Maryland Corporation (hereinafter referred to as "Prima"), instituted an action in the United States District Court for the Southern District of New York on November 12, 1965 seeking to rescind a contract of employment dated October 7, 1964, containing an arbitration clause, alleging that the defend-

ant-respondent, Flood & Conklin Mfg. Co. (hereinafter referred to as "F & C"), a New Jersey corporation, had falsely and fraudulently induced Prima, the plaintiff, to accelerate the closing date thereof and execute same (Plaintiff's complaint and Ex. A, contract in dispute, *infra*, p. 1C). Immediately prior to the institution of this federal action, F & C, defendant, had served upon Prima a notice of intention to arbitrate, dated October 25, 1965, by certified mail, pursuant to §7503(c) of the Civil Practice Law and Rules of the State of New York (Printed *infra*, p. 2B). Under the decisions of the New York courts, the substantive effect thereof would have been to preclude Prima from objecting that a valid agreement was not made, unless Prima applied to a court to stay arbitration.

The jurisdiction of the court below was founded solely on diversity of citizenship and amount (Complaint, p. 1C). Petitioner alleged that respondent, knowingly, falsely and fraudulently represented that it was a solvent corporation, whereas seven days after execution of the said agreement, respondent F & C filed a voluntary petition under Chapter XI of the Bankruptcy Act and a Receiver of its property was appointed. Upon confirmation of its arrangement proceedings, respondent was revested with title to its property and the instant litigation ensued.

Contemporaneously with the institution of its suit, petitioner sought an order of the District Court pursuant to Rule 65, Federal Rules of Civil Procedure, to stay arbitration pending a disposition of its action instituted for rescission of contract. At the same time, the respondent moved pursuant to Rule 7(b) of the Federal Rules of Civil Procedure and 9 U. S. C. §1, *et seq.*, of the Federal Arbi-

tration Act to stay the federal action seeking rescission and obtain a direction of the Court to compel arbitration on the ground that the parties had, by virtue of an arbitration clause, agreed to arbitrate "any controversy or claim arising out of or relating to this agreement, or the breach thereof, ..."

Upon a finding that no fraud was specifically alleged with regard to the arbitration provision and that the said arbitration provision is sufficiently broad to cover a dispute of fraudulent inducement (p. 11A) the district court denied petitioner's motion to stay arbitration and granted the respondent's motion to compel arbitration, relying on the precedent established by *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2 Cir. 1959), *cert. granted*, 362 U. S. 909 (1960), *dismissed pursuant to Rule 60*, 364 U. S. 801 (1960).

An appeal was timely taken to the Court of Appeals, but prior to the time within which the record, briefs and appendices were to be filed, the defendant-appellee moved to dismiss the appeal as frivolous. Upon oral argument of the motion, the Court, at its own request and with consent of counsel, agreed to hear and determine the appeal on its merits, resulting in an opinion and order dismissing the appeal (p. 1a).

The Court of Appeals reaffirmed the precedent originally established by it in this Circuit in the case of *Robert Lawrence Company, supra,* holding that an arbitration agreement is separable from the contract within which it is contained, and that as such, where there is no allegation of fraud in the inducement to enter into the agreement to arbitrate, the resolution of whether there was in fact fraud

in the inducement is properly within the province of the arbitrators and not of the court. It further reaffirmed the unique principles established by it in the *Robert Lawrence* case that "the Arbitration Act in making agreements to arbitrate 'valid, irrevocable, and enforceable' *created national substantive law* clearly constitutional . . . and that the rights thus created are to be adjudicated by the federal courts whenever such courts have subject matter jurisdiction, *including diversity cases* . . ." (Emphasis supplied) (p. 12a).

Reasons for Granting the Writ

1. The Court of Appeals has reaffirmed an important question of federal law which has not been, but should be, settled by this Court.

This Court on March 7, 1960, granted a petition for a writ of certiorari in the case of *Robert Lawrence Company* v. *Devonshire Fabrics, Inc., supra.* The constitutional questions then presented were never resolved since the Writ of Certiorari was dismissed under Rule 60 as a result of the litigants settling their dispute. Reproduced, *infra* at pp. 1D-7D, are pages 5 through 12 of the petition of *Robert Lawrence Company* for Writ of Certiorari, wherein it eloquently sets forth the then compelling and cogent reasons why Certiorari should be and *was granted.* The fundamental reasons for granting the writ then are no less important now. The conflict of decisional law amongst the different circuits must be resolved and the constitutional questions relating to the proper application of substantive law, again raised herein, should be finally determined and laid to rest.

2. The Court of Appeals has wholly disregarded the constitutional caveat set forth in *Bernhardt* v. *Polygraphic Co. of America, Inc.*, 350 U. S. 198, 76 S. Ct. 273, 100 L. Ed. 199 (1956), by Mr. Justice Douglas in the opinion of the court, at p. 202:

> "We deal here with a right to recover that owes its existence to one of the States, not to the United States. The federal court enforces the state-created right by rules of procedure which it has acquired from the Federal Government and which therefore are not identical with those of the state courts. Yet, in spite of that difference in procedure, the federal court enforcing a state-created right in a diversity case is, as we said in *Guaranty Trust Co.* v. *York* (citation omitted), in substance 'only another court of the State.' The federal court therefore may not 'substantially affect the enforcement of the right as given by the State.' (citation omitted). If the federal court allows arbitration where the state court would disallow it, the outcome of litigation might depend on the courthouse where suit is brought. For the remedy by arbitration, whatever its merits or shortcomings, substantially affects the cause of action created by the State."

and again at p. 204:

> "There would in our judgment be a resultant discrimination if the parties suing on a Vermont cause of action in the federal court were remitted to arbitration, while those suing in the Vermont court could not be."

The Court of Appeals further ignored the constitutional question presented by Mr. Justice Frankfurter in his concurring opinion in *Bernhardt,* at p. 208, where he stated:

> "It would raise a serious question of constitutional law whether Congress could subject to arbitration litigation in the federal courts which is there solely because it is 'between Citizens of different States', U. S. Const., Art. III, §2, in disregard of the law of the State in which a federal court is sitting."

The substantive law of New York has not been altered. Fraud in the inducement of contract is a justiciable issue to be determined not by arbitration but by the court. The *Robert Lawrence* case acknowledged the substantive New York law when it noted, at p. 412:

> "We note that were we compelled to apply New York law to the principles involved in this case, we would have been forced to arrive at a contrary conclusion."

In June, 1960, the First Circuit Court of Appeals in *Lummus Company* v. *Commonwealth Oil Refining Co.,* 280 F. 2d 915 (1st Cir. 1960) *rehearing denied,* 280 F. 2d 932, *cert. denied,* 364 U. S. 911 (1960), which involved similar issues raised herein, i.e., separability of the arbitration clause and after examining at length the Second Circuit decision in the *Robert Lawrence* case, noted serous constitutional questions involved and observed at p. 924, n. 9:

> "In the Robert Lawrence case, the Second Circuit treated the separability issue as a matter of federal law under the U. S. Arbitration Act. We

question whether separability is a matter of federal rather than state law in a diversity case, whether or not the federal arbitration act applies for other purposes."

The court exhaustively examined into the substantive law of New York as to the issue of the separability of contract when it is alleged there was fraud in the inducement. It remarked at length, time and time again, on the distinction and difference in result, where a claim is made for damages for fraud in the inducement, as opposed to equitable rescission.

In the instant case, the court while noting that petitioner in its complaint seeks only equitable rescission of the contract (p. 11A) wholly disregarded the distinction and erroneously concluded that, inasmuch as the allegation is alleged fraudulent inducement, this issue was still arbitrable. It manifested complete indifference to the substantive rights created by virtue of petitioner's election of an equitable remedy.

The decision in the case at bar is in acknowledged conflict with the decision of the First Circuit in *Lummus, supra,* which decision followed the granting of certiorari in the *Robert Lawrence* case.

On rehearing, the court noted at p. 932 that it predicated its opinion on a finding "that Commonwealth was not really pursuing a restitutionary remedy . . . but that the true nature of the action was an endeavor to recover damages while rescinding the arbitration agreement alone . . . Although we recognize that New York may regard an arbitration clause as falling upon a rescission of the prin-

cipal agreement, we do not believe that it would carry this to the point of permitting . . . what in effect would be a true rescission of the arbitration clause only.'"

3. In the instant case, the defendant, F & C first elected to enforce and invoke to its *own benefit* the substantive effect of New York law by serving upon petitioner, Prima, a notice of intention to arbitrate under §7503(c) of the Civil Practice Law and Rules of the State of New York (p. 14C). Applying the substantive law of the State of New York, the petitioner would have been precluded and barred from objecting to the validity of the agreement unless the petitioner applied to a court to stay arbitration (p. 2B).

Petitioner could have chosen as a forum the state court offered by the defendant in its notice. Petitioner, however, pursuant to its constitutional privilege, sought its state-created substantive remedy in the federal district court based solely on diversity of citizenship between the litigants. Due to petitioner exercising its constitutional prerogatives, an anomalous result was achieved. The federal district court arrived at a result contrary to that which would have been obtained in the state courthouse next door. Accordingly, it is clear that there has been a serious deprivation of petitioner's constitutional rights which ought to be rectified by this court.

4. The only difference between the questions presented in the petition for a writ of certiorari in the *Robert Lawrence* case and the instant application, is that in the *Robert Lawrence* case the litigants conceded the fact that the contract, which was an interstate shipment of goods, con-

stituted a transaction in interstate commerce. In the instant case, the Court of Appeals held "Beyond peradventure the contract evidences a transaction involving interstate commerce" (p. 9A). It completely disregarded *Bernhardt* v. *Polygraphic Co. of America, Inc., supra, although* the case was cited at length in the briefs and argued extensively orally.

Since the question of jurisdiction under 9 U. S. C. A. is dependent upon whether the arbitration clause was a provision in a maritime transaction (not applicable here) or in a contract evidencing a transaction involving commerce, it becomes necessary to examine the pertinent facts to determine if the contract for the employment of F & C was a contract in interstate commerce.

The agreement herein employed F & C to work for Prima for a six year period (p. 5C; Paragraph 1). If the agreement had been carried into effect, Jerome K. Jelin, Chairman of F & C would have been required to perform the services of employment on behalf of F & C. Only his out-of-pocket expenses would have been reimbursed by Prima (p. 5C; Paragraph 2).

These facts do not make this contract one involving interstate commerce (*San Carlo Opera Co.* v. *Conley,* 72 F. S. 825, D. C. S. D. N. Y., 1946, *affirmed,* 163 Fed. 2d 310 (2d Cir. 1947). Any travel in connection with the agreement is a mere incident, not the essential thing. That to which it is incident—the advice and consultation—would not be called trade or commerce in the commonly accepted use of these words. Personal effort, not related to production, is not a subject of commerce. That which is in its consummation, not commerce, does not become commerce

among the states because transportation takes place (*Federal Baseball Club* v. *National League*, 259 U. S. 200; *Hart* v. *B. F. Keith Vaudville Exchange*, 12 Fed. 2d 341 (2d Cir.), *cert. denied*, 273 U. S. 704).

In the *Bernhardt* case, *supra*, the employee was a plant superintendent earning $15,000.00 a year with managerial duties fundamentally different than those of workers.

The Second Circuit, in a later opinion, *Metro Industrial Painting Corp.* v. *Terminal Construction Corp.*, 287 Fed. 2d 382, 387 (2d Cir. 1961), *cert. denied*, 368 U. S. 817, 82 S. Ct. 31 (1961), recognized that such an issue raises questions of fact when it observed,

> "The significant question, therefore, is not whether, in carrying out the terms of the contract, the parties *did* cross state lines, but whether, at the time they entered into it and accepted the arbitration clause, they *contemplated* substantial interstate activity. Cogent evidence regarding their state of mind at the time would be the terms of the contract and if it, on its face evidences interstate traffic, such as did the shipment from New York to Massachusetts in the Lawrence case, the contract would come within §2. In addition, evidence as to how the parties expected the contract to be performed and how it was performed is relevant to whether substantial interstate activity was contemplated."
>
> "the fact that it is necessary for one party to cross state lines in order to fulfill obligations arising out of the contract should not by itself bring the arbitration clause within the reach of the Federal Statute . . ." (*id.*, p. 388)

Squarely in point with the *San Carlo Opera* case, *supra*, the agreement involved herein was essentially personal employment and specified the particular person who would render said employment and therefore cannot be construed as commerce.

5. This court recognized the novel principle and far reaching effect resulting from *Robert Lawrence* when it took cognizance thereof and granted certiorari in 1960. There has been no change in the diverse opinions as between the various circuits, and this court has not passed upon the questions again presented herein since certiorari was granted in the *Robert Lawrence* case. The important questions of federal law, their far reaching effect and implications, their impact on commercial transactions, have not lessened in the interim. This court should grant this petition for the reasons set forth in the petition of *Robert Lawrence Company*, reproduced *infra* (p. 1D-7D), and for all of the additional reasons set forth above.

CONCLUSION

It is therefore respectfully submitted that this petition for a writ of certiorari be granted.

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